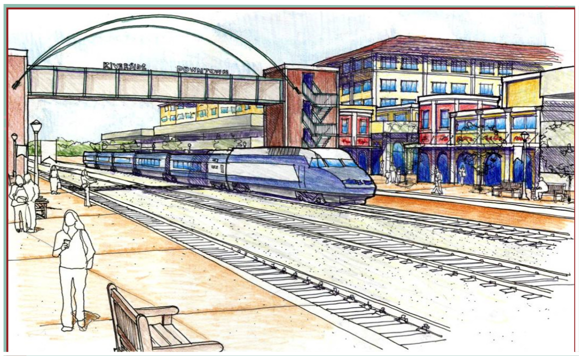

May 2008

PREPARED BY

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SOUTHERN CALIFORNIA ASSOCIATION OF GOVERNMENTS

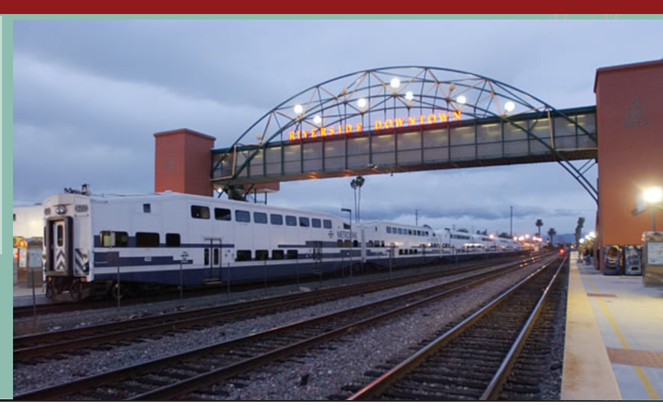
8TH ANNUAL REGIONAL HOUSING SUMMIT

THE MORTGAGE LENDING CRISIS
IMPACT ON PEOPLE AND PLACES

NAVIGATING THE COURSE

COMPASS BLUEPRINT

building partnerships. serving communities.



The Mortgage and Subprime Lending Crisis will have a tremendous impact on the economy, personal wealth, property values and tax revenues. Families, neighborhood property values, and state and local governments will lose billions of dollars as two million subprime mortgage homes are foreclosed. It is also allowing the American Dream to slip away from millions of households. Many of them live, work, and raise families in Southern California, and this is why this topic is the focus of SCAG's 8th Annual Regional Housing Summit.

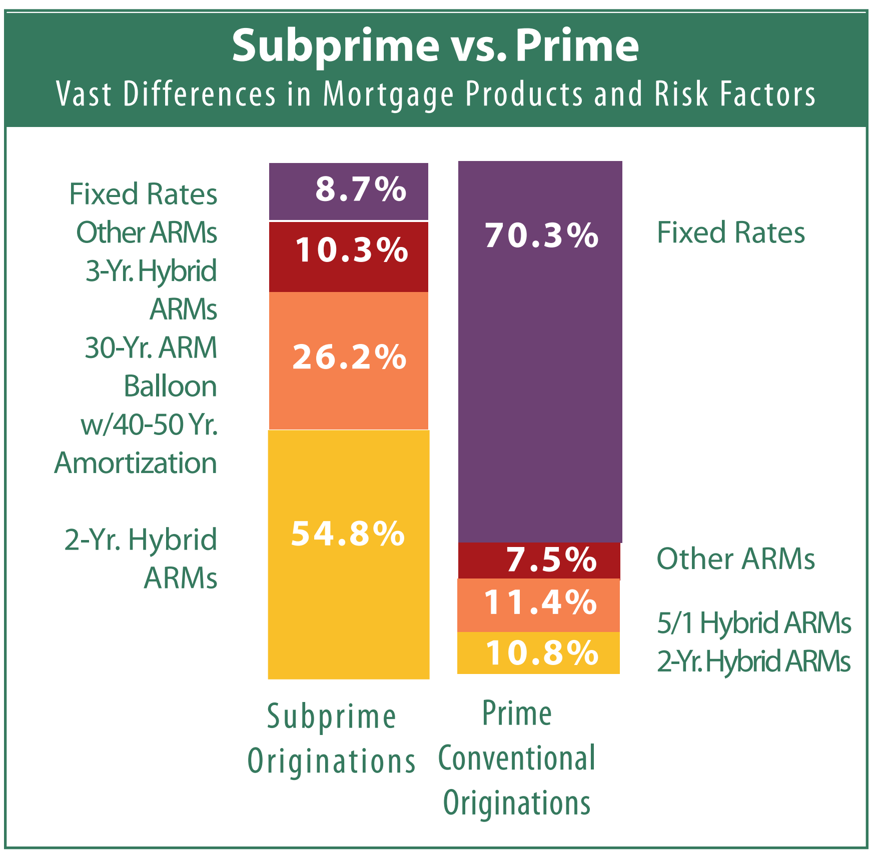
Building and sustaining homeownership, particularly for immigrants and minorities, is one of the best means there is for building and sustaining a large and vibrant middle class. As noted by Richard F. Syron, the Chairman and CEO of Freddie Mac, "The two greatest challenges the United States faces in the 21st century are race and income inequality. Housing is where they come together."

The subprime and larger mortgage crisis among homeowners and buyers also places downward pressure on economic growth, because fewer or more expensive loans decrease business investment and consumer spending, which drive the economy. A separate but related dynamic is the downturn in the housing market, where a surplus inventory of homes has resulted in a significant decline in new home construction and sharp drop in housing prices in many areas that places a great burden on both inner city and suburban neighborhoods.

The Subprime Lending Crisis: A Set Back for Achieving Homeownership Goals, Especially for Minorities and Immigrants

While there is no readily agreed upon definition, "subprime" is generally thought to refer to mortgage lending to borrowers with impaired credit evidenced by low credit scores or little credit history. At the end of 2006, the median credit score of subprime borrowers was 618 compared to 733 for prime borrowers.

On the product side, Freddie Mac reports, 91% of mortgages originated in the subprime market in 2006 were adjustable-rate mortgages (ARMs) with approximately one-half the 2/28 hybrid variety



Source: Freddie Mac. August 2007

– that is, 2 years of a fixed rate, followed by payment resets usually every 6 months thereafter. In the prime conventional market, 70% of loans originated were fixed-rate mortgages; the most common ARM was the 5/1 ARM (accounting for nearly one-half of hybrid ARMs), providing borrowers with 5 years of protection from interest-rate risk and annual payment adjustments thereafter.

Unfortunately, the credit squeeze triggered by the current meltdown in the subprime mortgage market is preventing buyers with good credit from getting "jumbo" mortgages – loans higher than $417,000, Freddie Mac's lending limit. Today borrowers can pay up to a full percentage point more for a $418,000 loan than a conforming loan at or below $417,000. That may not sound like a lot, but it's thousands of dollars per year and tens of thousands of savings foregone over the life of the loans.

The American Dream Slips Away

During the fourth quarter of 2007 (latest data available from Real Estate Research Council of Southern California), default notices in the Southland increased year over year by 98%, while foreclosures soared 360% over a year ago and exceeded levels ever seen in the region. Hardest hit borrowers are minorities and immigrants, and neighborhoods with high concentrations of subprime borrowers and foreclosure filings.

African-Americans and Latinos face different levels of pricing disparities when compared with white borrowers. When they are steered into higher-cost loans, the path to prosperity is made steeper. That means that it's even harder for minorities and immigrants to build equity for their future. It's even harder to send their children to college and it's even harder to build wealth for the next generation.

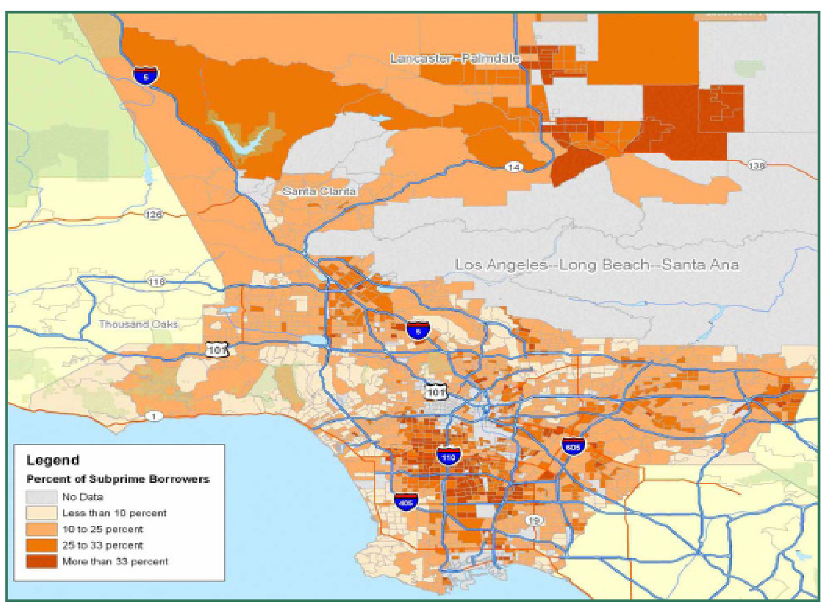
The nation set a record of homeownership achievements in the past few years, but also experienced a record decline in the homeownership rate caused by subprime borrowing. This suggests that many people have stretched too far to reach the American Dream.

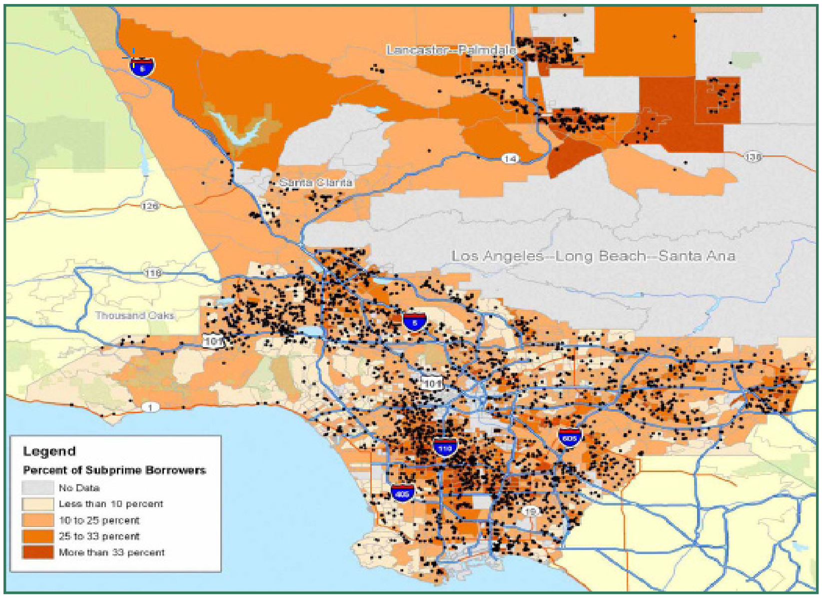
Impacts along the Transit Grid in Coastal Counties

Inner city neighborhoods near transit and ex-urban subdivision are often targeted for subprime lending because bargain priced housing is available, but this is where home ownership setbacks for minority and immigrant households are greatest. Personal wealth building for lower income and minority households is not what it may appear to be.

The following two Los Angeles County maps show subprime borrower concentration and where foreclosure filings – represented as one dot per foreclosure – are occurring. The information was compiled by the Federal Reserve Bank of SF. Although the current crisis began with sub-prime loans -- mortgages made to borrowers with low incomes or poor credit -- delinquencies and foreclosures are on the rise for prime loans as well.

Subprime Borrower Concentrations in Los Angeles County - 2006





Foreclosure Filings in Los Angeles County - 2006

their house than what it's worth and having no equity (either from little money down or from declining home values due to the current market situation). Unless they are able to afford the reset or obtain refinancing, these households will have to have short sales (selling a home for less than the remaining mortgage amount), or "walk away" and let the banks foreclose.

New housing and existing neighborhoods along Regional Transit Grid will not escape these consequences. The mortgage crisis is not just in the suburbs where people were "driving to qualify," it's also in-town and near our employment and transit corridors and centers.

The Story is also About Wiped-Out Equity

The whole story of the housing crisis isn't just the subprime meltdown and foreclosures; it's also about wiped-out equity from declining home values, the inability to sell (especially for people reliant on their homes for retirement) or inability to tap into emergency funds via equity lines, and banks (and their shareholders) that approved "affordable" loans. For example, Countrywide Financial, the nation's largest mortgage lender, suspended the home equity lines of 122,000 customers after reviewing their property values and outstanding loan balances in January 2008.

Declining home values could wipe out the equity that homeowners need to qualify for new mortgages. While the current resets are mostly for subprime borrowers, the majority of resets in June 2009 will be Prime, and option ARMs. Most of these people expected the ability to refinance when they took out their loans, which might not be feasible if they owe more on

Early 2008

"Home prices are still far above historical norms when compared to other measures such as rent or GDP. By our calculations, it will take about a 20 to 30 percent decline in home prices to correct this imbalance."

Merrill Lynch

Market Uncertainty Halts Construction Plans

The current housing crisis and the depreciation in home prices have pummeled the economy, with businesses and consumers cutting back on spending, raising the specter of a recession. But CNNMoney reported early in 2008 that for those who think that the worst is over, Merrill Lynch said that housing prices still remain comparatively high. The brokerage believes that home prices are still far above historical norms when compared to other measures such as rent or GDP. "By our calculations, it will take about a 20 to 30 percent decline in home prices to correct this imbalance," said the report. The major challenge for home sellers in 2008 is to shed excess supply. Home building cannot recover until the existing inventory of unsold homes moves in-line with demand. Merrill Lynch believes that housing starts will most likely slide another 30 percent by the end of 2008 - a historic low. Because of its $1.3

billion purchase of First Franklin Financial, Merrill Lynch became the world's top underwriter of subprime-mortgage-backed securities in 2007. Bank of America becomes the nation's largest lender with its purchase of Countrywide, which is expected to be completed in June 2008.

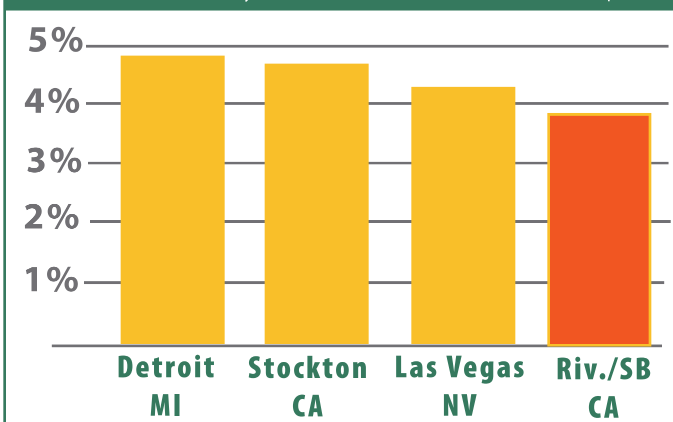
Homebuilders are now looking at more than a nine months' supply. "The current supply/demand environment does not favor a swift recovery in the housing market..." The report came the same day that one of the nation's largest builders, KB Home (KBH, Fortune 500), reported a large widening of its quarterly loss at the beginning of 2008. The loss was much worse than forecasts due largely to writedowns in the value of its holdings and the cost of getting out of some land purchase options.

KB Home is not the only builder to be hit by large charges due to the downturn in the housing market. No. 1 builder Lennar, as well as No. 2 Centex, No. 4 Pulte Homes and No. 6 Hovnanian Enterprises, all reported bigger-than-expected losses due to such charges.

Foreclosures have reached all-time highs in San Bernardino and Riverside, and are only forecast to increase over the next two years as more adjustable rate mortgages reset. The housing crisis is impacting the local economy as more and more home owners desert and leave them vacant and unmaintained. The Inland Empire is forecast to see up to 17% in housing price deflation through year's end on the average home.

Sliding Housing Market

Only three metro areas recorded more foreclosure-related activity in 2007 than the inland empire



Impact on the Inland Empire and Desert Areas

Mortgage problems are more severe in fast growing and relatively more affordable areas when borrowers can't afford the new higher monthly payments when their adjustable loans or interest only or other non-traditional fixed rate loan resets. Worsening the risk of default, it was common for subprime borrowers without the means for a down payment to obtain 100 percent financing and to qualify for a mortgage they could not otherwise afford. In some cases, borrowers were not required to fully document their income and repayment capacity at a fully indexed rate. Many of the loans also allowed borrowers to make interest-only monthly payments to start, but in a few years the payments would jump sharply to include both principal and interest at a higher rate.

At the end of 2006, there were 229,268 adjustable-rate mortgages between one and three years old in San Bernardino and Riverside counties. Almost 32 percent of those were subprime, according to First American's Loan Performance. Forty-three percent of all adjustable mortgages, including subprime, are expected to reset this year and the remainder are expected to reset by 2010."

Normally, homeowners who got into financial trouble were not often at risk of losing their homes, as they could sell or refinance. This is not the case in a declining market where home prices are falling. Homeowners are going into foreclosure and in many cases may not have been truthful about stated incomes needed to qualify for these loans, in some cases unethical loan officers or mortgage brokers took advantage of families by arranging loans they couldn't afford; adjustable rates are then resetting into mortgage payments that these borrowers cannot afford. New types of loans like interest-only mortgages and cash-out refinance loans mean buyers do not pay down their mortgages, and results in "negative amortization." And adjustable rate mortgages, which accounted for 39 percent of mortgages written in 2006, expose owners to rent-like rises in their housing costs. The value of homeownership has increasingly shifted to the home's likelihood to rise in value, and when an investment goes bad, people may tend to walk away. This type of desperate, financial decision marks a shift in home ownership attitudes.

But another large and troubling reality is that home prices are falling across the southland. These falling home values have taken away refinancing and selling off the home as an alternatives to foreclosure. Some buyers may "walk away" since the loan is higher than the value of the property and any equity in the property is gone. In the SCAG region, it is not resets of adjustable rate mortgages that are so much the trouble, but declining home prices that prevent people from refinancing or selling. Homeowners were spending more than they were earning and depending upon home equity loans to fill the gap.

However, as property values dropped, home equity lessened and there was "no way out" for homeowners. This has exacerbated the housing market decline and further reduced lender willingness to make loans to both prime and subprime borrowers.

The Mortgage Crisis affecting individual homeowners has had a domino impact on whole communities. More and more vulnerable homeowners and neighborhoods are seeing increases in vacant, unkempt properties, blight, squatters, more crime, decreases in property values and lower city tax revenues. This in turn hampers a community's ability to provide good schools, police protection, code enforcement and other services.

The median home price in a six-county region of Southern California plunged more than 13 percent in December 2007 versus a year ago, as the national housing slump kept eating away at home values, a real estate research firm said Tuesday. The average median price in Los Angeles, Orange, San Diego, Ventura, Riverside and San Bernardino counties hit $425,000 last month, the lowest level since February 2005, when the figure was $420,000, according to DataQuick Information Systems.

January Sales

Median prices and number of new and previously owned homes sold

	Median Price (thousands)	% change from year ago	Number of homes sold	% change from year ago
Riverside	$331.5	-20.1	1,939	-37.2
San Bernardino	$298.5	-19.3	1,111	-53.2
Ventura	$477.8	-15.4	423	-38.6
Orange	$520.0	-13.3	1,286	-46.4
Los Angeles	$458.0	-11.9	3,398	-50.1
San Diego	$429.0	-9.1	1,826	-34.1
Overall	$415.0	-14.4	9,983	-44.9

The real estate market in Southern California is crippled by uncertainty and credit constraints. Fewer than 10,000 homes were sold in the six-county region. Sales in February fell to the lowest level ever measured by DataQuick. Dataquick also reported that roughly one out of every three houses that did sell had been foreclosed on earlier this year. In Riverside County, prices have fallen 20% over the past year and 48% of February sales were of foreclosed homes. These foreclosure sales have a significant impact on neighborhood quality and pose a financial burden of significant magnitude to communities.

The Costs of Foreclosure

- ***Neither lenders nor investors "make money" on foreclosures***
- ***Losses range from 20 cents to 60 cents on the dollar***
- ***One estimate: lender's cost of a foreclosure averages $58,800***
- ***Servicers incur expense pursuing problem loans***
- ***Legal costs and costs of securing/maintaining properties***
- ***Vacant properties can attract crime and reduce neighborhood property values***
- ***One estimate: each foreclosure resulted in a 0.9% decrease in values of properties within 1/8th mile***
- ***Average municipal cost of $7,000 per foreclosure***

Source: Federal Reserve Bank of SF estimates

As previously reported in the New York Times, the crashing housing market has flattened the home equity gains that once fueled housing's boom, with 8.8 million homeowners, or 10.3 percent of the total, now owing more than they own. This is the greatest upside-down market since the Great Depression.

How did this happen?

Historically, defaults and foreclosures have been very low, even for subprime borrowers who still paid back their loans after paying higher fees to mortgage bankers and brokers to borrow. The crisis can be attributed to a number of factors, such as the lowering of interest rates by the Federal Reserve Bank (The Fed) to promote economic stability and growth after 9/11; the subsequent boom in construction and housing prices; the inability of homeowners to qualify or make their mortgage payments without resorting to riskier loan products; poor judgment by either the borrower or the lender or both in choosing home loans; inappropriate mortgage incentives, and rising adjustable mortgage rates in conjunction with falling home values or unemployment. The Fed had substantial regulatory and moral-suasion power to curb excesses but did not use them. Further, declining home prices have made re-financing particularly more difficult as the housing bubble burst in California because of the significant gap between income, rents, and home prices. There are also other dynamics and dimensions of the crisis that complicates the assignment of blame.

One Problem is the "Housing Bubble" Attracted Both Predatory Lenders and Predatory Borrowers

There were also the appraisers that buckled under lenders intent on closing loans, the actions of S&P and Moody's that turned shoddy mortgages into respectable bonds or collateralized debt, and the Federal Reserve that set the interest rate policy which resulted in a national housing bubble and then did not deal with the excesses. The resulting credit crunch caused the nation's largest lender – Countywide - to pull back from making subprime loans and to be bought by another lender, while the No. 1 bank Citicorp and No. 1 brokerage Merrill Lynch had to write off billions of dollars in subprime loans and saw their CEO's resign. National, State, and public and private intervention efforts are now underway, most notably by the six largest banks in the county are cooperating in a program known as Project Lifeline, which is an effort to freeze some foreclosures to give lenders a chance to work out ways to let borrowers keep their homes. The banks under the program are: Bank America, Citigroup, Countrywide, JP Morgan Chase, Washington Mutual and Wells Fargo.

Freddie Mac and Fannie Mae can now purchase loans worth as much as $793,000, while the FHA can insure loans for up to $729,000. The new, higher loan limits will stay in effect through the end of the year, allowing the government sponsored enterprises (GSEs), to buy much higher-priced mortgages in some areas of the country. This addresses the dilemma in high housing expense areas where the typical home costs far more than the prior conforming loan limit, and non-conforming or "jumbo loans" carry interest rates of about a point higher.

The high cost of housing in Southern California makes people stretch to make homeownership possible. For example, a $500,000 mortgage is additionally costing $330 a month. In part, the inability to qualify for a conforming loan spurred the demand for subprime and exotic loans to help make up the difference. By raising the conforming loan limit, it is felt that mortgage costs will be moderated and the liquidity freeze in high cost markets will be eased because jumbo loans are more expensive and very difficult to qualify for. The lack of qualified buyers has contributed to the reductions in home sales in pricier market areas. Also, the size of the loans that the Federal Housing Authority (FHA) can insure was raised by Housing and Urban Development (HUD) and this will also help qualify more modest income buyers.

New Loan Limits for Fannie Mae and Freddie Mac in the SCAG Region

County	Limit
Riverside	$500,000
San Bernardino	$500,000
Ventura	$729,750
Orange	$729,750
Los Angeles	$729,750

Why This May Help Homeowners In California

The move would likely mean lower interest rates on loans in the $417,000 to $729,000 range. That would help buyers in that price range, and owners in that price range who are looking to refinance into fixed-rate loans. Maybe more important, it helps lenders find a willing buyer for their jumbos. But there is a declining market stinger, which raises the interest rate in hard hit, high cost markets. These loans also expose Freddie and Fannie -- and ultimately taxpayers -- to some of the least stable housing markets in America, which are the expensive ones. Taxpayers all across the country are now supporting California-sized mortgages - one LA mortgage instead of three Cleveland normal sized loans. These higher jumbo limits are temporary and will expire on Dec. 31, 2008, but affording these new jumbo loans will be harder because of tougher eligibility standards.

For example, in the guidelines for what Fannie Mae calls its new "jumbo conforming" program, the company will, beginning April 1, purchase fixed-rate mortgages up to $729,750, but only with the conditions outlined here.

Fannie Mae "Jumbo Conforming Program" Conditions

- ***Minimum down payment of 10%.***

- ***Minimum FICO credit score of 700 for any loan with less than a 20% down payment. "Nontraditional" credit histories as alternatives to FICOs are not permitted as in other programs.***

- ***Minimum 40% down payment and 660 FICO for second homes and investor properties.***

- ***No balloon or negative-amortization payment terms allowed.***

- ***Household debt-to-income ratios cannot exceed 45%.***

Freddie Mac announced similar standards but wants minimum 700 FICO scores on any loan with less than a 25% down payment. Besides higher base rates, there are add-on charges in "declining" markets that can push final note rates beyond 7 1/2 % in some cases.

Many neighborhoods and geographic areas in Southern California are tagged as declining, former housing boom markets, and also the places where jumbo loans are most common and where relief is most needed.

Reform Options That Would Preserve The Benefits Of Subprime Financing While Safeguarding Homebuyers

Promoting homeownership has long been a policy priority in America; increasing access to credit has been key to increasing the rate of homeownership overall, and particularly among low income and minority households. Growth in the subprime market has benefited many homebuyers who might not otherwise have been able to access the credit they needed to purchase homes; the downside to this trend is some of these households are paying more than they need to for their home loans, and are burdened with loans that they cannot afford. This elevates foreclosure risk, especially when housing market conditions worsen and values fall. First time buyers are most at risk because they have had the least time to build equity. When an owner has nothing in the home and houses are selling below what is owed in their neighborhood, one may very well conclude that it is cheaper to rent and let the bank have the house.

The current crisis in the mortgage market should force the nation and the region to reconsider many assumptions about home ownership, mortgage lending and securitization - the process of generating bonds from mortgages and other forms of debt. It is important, however, that any regulatory changes made in response to this crisis should not dismantle the progress in making homeownership more available for low-income and minority households and communities. But more home buyer protection and due diligence is needed in making loan decisions since the impact on communities and the economy can be significant.

The new book by economist, Edward M. Gramlich entitled "Subprime Mortgages: America's Latest Boom and Bust" offers a slate of reform opportunities for the ailing subprime mortgage market and provides one of the first comprehensive analyses of this still-evolving segment of the mortgage industry .

• **Supervision.** Increase the federal supervision of now largely unsupervised lenders and brokers. Force lenders to evaluate a borrower's ability to pay using the maximum possible interest rate, not the lower teaser rate.

• **Government regulation.** Expand the Home Owner Equity Protection Act, which battles predatory lending. Reorient Fannie Mae's and Freddie Mac's practices to complement HOEPA.

• **Community-based organizations.** Increase the capacity of these watchdog and consumer-support groups to provide education, counseling, and alternative sources of credit.

• **Market pressure.** Encourage self-enforcement practices by lenders that strengthen borrowers' rights, lessening foreclosures and benefiting both homeowners and the mortgage industry.

• **Rental markets.** Ensure an adequate supply of rental housing so families won't become homeowners just because they have no other option.

The California Legislature is considering a number of bills addressing today's mortgage crisis. Mortgage assistance is also available over the web for households needing assistance . The high proportion of non-traditional or exotic mortgages, along with the concentration of subprime borrowers are in modest suburban communities and inner city areas with high concentrations of minority and immigrant subprime borrowers. These neighborhoods are also places where investors bought houses to flip based on expected appreciation.

Reaching out to these borrowers and neighborhoods will be critical in helping to mitigate the costs of foreclosures for borrowers, homeowners, lenders and local governments. Targeted home buyer counseling and anti- predatory loan protection in areas with large numbers of subprime borrowers or in at-risk neighborhoods may be an effective strategy for preventing future foreclosures, and helping low, moderate and even middle income households and minorities achieve and maintain homeownership.

A surge in subprime lending, especially in highly risky versions of these loans, was coincident with record levels of home ownership in the nation and the SCAG region that peaked in 2005 and 2006. These gains were short-lived and slipped away with the onset of the mortgage and lending crisis and the ensuing record levels of foreclosures. Many homeowners are forced to choose between making monthly payments on new or reset loans that exceed current home values or rents, and "walking away" from their investments and giving them up to their banks or lenders. Potential home buyers are waiting out the uncertainties of a housing market moving through a significant correction period and toward a market setting where home values, rents and incomes are in a more reasonable relationship with each other, and signal that it is once again time to buy.

Fast Facts on Foreclosures from Realtytrac

The main factor behind the CA foreclosure surge remains the decline in home values

California ranked second among states in the rate of foreclosure, trailing only Nevada

State Department of Housing and Community Development (HCD) reports:

Property taxes could decline by $2.96 billion

State expects to lose $994 million in sales tax revenues due to weakening consumer spending

Latest news from Southern California (LA Times and Dataquick)

In Southern California, foreclosures in the first quarter of 2008 grew most rapidly in Imperial County - which reported a 653% increase.
Foreclosures jumped 329.4% in Orange County and 314.5% in Los Angeles County. In the Inland Empire, San Bernardino posted a 397.8% increase and Riverside a 346.5% hike

In Southern California, 25,024 homes were repossessed in the first quarter this year, up 316.7% from the same quarter a year ago

The Southern California Association of Governments